A REPORT ON CREDIT INSURANCE IN MASSACHUSETTS 2007

A report to the Joint Committee on Financial Services,
the Senate Committee on Ways and Means, and
House Committee on Ways and Means
of the Massachusetts General Court,
the Attorney General,
and the Secretary of the Commonwealth

October 1, 2008

NONNIE S. BURNES
COMMISSIONER OF INSURANCE

Acknowledgements

The enclosed report was prepared by the State Rating Bureau staff of the Massachusetts Division of Insurance (“Division”). Chet Lewandowski and Kevin Beagan prepared the report and provided the analysis. The report is based primarily on responses from companies reflecting the experience of companies offering credit insurance in Massachusetts. Unless otherwise noted in the report, references to credit insurance, includes credit life insurance, credit disability insurance and credit involuntary unemployment insurance.

The Division makes all appropriate efforts to check the completeness and consistency of data reported by insurance companies and their statistical agents, but does rely on the insurance companies for the accuracy of all reported information.

Annual Reports

The Division produces an annual report on credit insurance pursuant to M.G.L. c. 175, §117C. The style and content of this year’s report differs from that of prior year reports to include credit involuntary unemployment insurance for the first time, and to explain a company’s obligation to refile rates when they do not meet statutory loss ratio requirements.

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Section 1 Overview of Credit Insurance

Credit insurance is a line of insurance coverage that may be offered to debtors of a lending organization for lines of credit other than a residential first mortgage (also known as "first lien on a residential property")[1]. Depending on what coverage is purchased, credit insurance may pay all of a debt or the required minimum periodic payments. Under Massachusetts law[2], it is illegal for a lender to require a person to buy credit insurance as a condition of obtaining a loan. Potential insureds are required to receive certain disclosure materials required by regulation[3] prior to any such coverage becoming effective.

This report describes credit insurance offered by licensed or authorized insurers and does not address non-insurance banking products - such as debt cancellation or debt suspension products - considered to be bank services. These products are not subject to state insurance laws or regulations.

Types of Credit Insurance

<u>Credit life insurance</u> is designed to pay off a specific debt in the event of the death of the insured. Unlike traditional life insurance, the beneficiary on the credit life insurance policy is the entity who offers the credit (the "creditor"), and not a friend or family member of the insured. Credit life insurance in Massachusetts is governed by the standards described in M.G.L. c. 175, §117C which are as follows:

(1) the death benefit may not be for more than $125,000;
(2) the insurance may not be for more than a 15-year period;
(3) the insurance may only be for the remaining outstanding balance of a debt; and
(4) the coverage ends when the debt is discharged.

By statute, an insurance company's credit life losses in relation to its earned premium – called the loss ratio - must be at least equal to 50%. Per M.G.L. c. 175, §117C, a company is required to report its credit life insurance premium and loss experience annually. Companies whose loss experience is credible and which did not meet the required loss ratio standard are required to file revised rates which meet the statutorily required loss ratio standard

<u>Credit disability insurance</u>, also known as credit accident and sickness insurance, is designed to pay a monthly amount that is never less than the minimum monthly payment required under the debt agreement. Unlike traditional disability insurance, the beneficiary is the creditor and payments are made to the creditor instead of to the covered person. Credit disability insurance may only be offered in Massachusetts in accordance with to the standards set forth under M.G.L. c. 175, §117C that include the following:

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[1] As authorized under Chapter 303 of the Acts of 1988, credit insurance is to be used with a "loan for personal, family or household purpose, except in the case of a loan secured by a first lien on real property" (M.G.L. c. 255, §12G); "retail installment contract" (M.G.L. c. 255B § 10); "premium finance agreement" (M.G.L. c. 255C, §14A); or "retail installment sale agreement or revolving credit agreement (M.G.L. c. 255D, §26C).
[2] Chapter 303 of the Acts of 1988.
[3] 211 CMR 143.00.

(1) the monthly benefit is equal to the loan's minimum monthly payment;
(2) there may be an elimination period before a benefit is paid; and
(3) the benefit may or may not be retroactive.

By statute, an insurance company's loss ratio for credit disability insurance must equal at least 55%. Per M.G.L. c. 175, §117C, a company is required to report its credit disability insurance premiums and claims annually. Companies whose claims experience is credible and which did not meet the required loss ratio standard must file revised rates which meet the statutorily required loss ratio standard.

Credit involuntary unemployment insurance is designed to pay a monthly amount that is never less than the minimum monthly payment under the debt agreement. Unlike traditional involuntary unemployment insurance, the beneficiary is the creditor and payments are made to the creditor instead of the covered person. Credit involuntary unemployment insurance may only be offered in Massachusetts in accordance with the standards set forth under M.G.L. c. 175, §117D that include the following:

(1) the monthly benefit is equal to the loan's minimum monthly payment;
(2) there may be an elimination period before a benefit is paid; and
(3) the benefit may or may not be retroactive.

By statute, an insurance company's loss ratio for credit involuntary unemployment insurance must equal at least 60%. Per M.G.L. c. 175, §117D, a company is required to change its filed rates if its claims experience is credible and did not meet the statutorily required loss ratio standard.

Credit property insurance is designed to pay the outstanding balance under a debt agreement in case the covered property is destroyed by specific named perils such as an accident or theft. Usually this product does not have any upfront deductible.

Although the rates used for credit property insurance are to be actuarially supportable when filed with the Division, there is not a statutorily required loss ratio for this product and this product is not referenced in the data collected for this report.

Reporting by Classes of Business

The rates to be used for credit life and credit disability insurance offered through the Motor Vehicle Dealers (MVD) class of business – for auto-related loans – are set by the Division triennially using the last three available years of experience. (Bulletin 2007-09 identifies the rates applying to 2008, 2009 and 2010, based on 2004-2006 experience.) For all other classes of business, insurers are to submit rate filings for a specific line that comply with the statutorily defined standards[4]. In order to differentiate MVD credit insurance from all other credit insurance, the Division expects companies to maintain and report the experience of these lines separately.

[4] As defined in M.G.L. c. 175, §117C.

Section 2 Data and Reporting Requirements

Data Requirements

In accordance with M.G.L. c. 175, §117C(b)F each insurer is required to file claims experience and loss ratio data annually. The Commissioner of Insurance, by September 30th of each year, is required to provide a summary of the information reported by companies. When submitting information, insurers are to report claims and premium data and calculate a loss ratio in the following manner:

Incurred Claims = Total credit insurance claims paid during the experience period adjusted for changes to the credit insurance claim reserve.

Earned Premiums = Actual earned premiums

$$\text{Loss Ratio} = \frac{\text{Incurred Claims}}{\text{Earned Premiums}}$$

Reporting Requirements

When submitting credit insurance information, the Division has requested that companies report separately for credit life, credit disability and credit involuntary unemployment insurance. Second, within the Credit Life and Credit Disability reports, the Division has also requested that information be reported separately for the Motor Vehicle Dealer (MVD) class of business. (This information was not requested for the credit involuntary unemployment insurance because the Division does not set credit involuntary unemployment rates for any class of business.) The Division requested that the data be reported for each individual product that may be offered within a line of coverage so that the loss ratio of the individual product may be compared to the statutory loss ratio requirements.

Section 3 Credit Life Insurance

The following represents the experience reported by the 29 companies submitting reports for credit life insurance business in force between 2005 and 2007:

Motor Vehicle Dealer Class of Business

	2005	*2006*	*2007*	*Total 2005-2007*
Direct Premium Earned	4,670,873	4,664,212	3,949,087	13,284,172
Direct Losses Incurred	805,144	1,488,529	644,844	2,938,517
Loss Ratio	17.24%	31.91%	16.33%	22.12%

All Other Classes of Business

	2005	*2006*	*2007*	*Total 2005-2007*
Direct Premium Earned	7,609,648	7,577,459	7,223,736	22,410,843
Direct Losses Incurred	3,575,762	3,477,169	3,347,956	10,400,887
Loss Ratio	46.99%	45.89%	46.35%	46.41%

Motor Vehicle Dealer Class and All Other Classes Combined

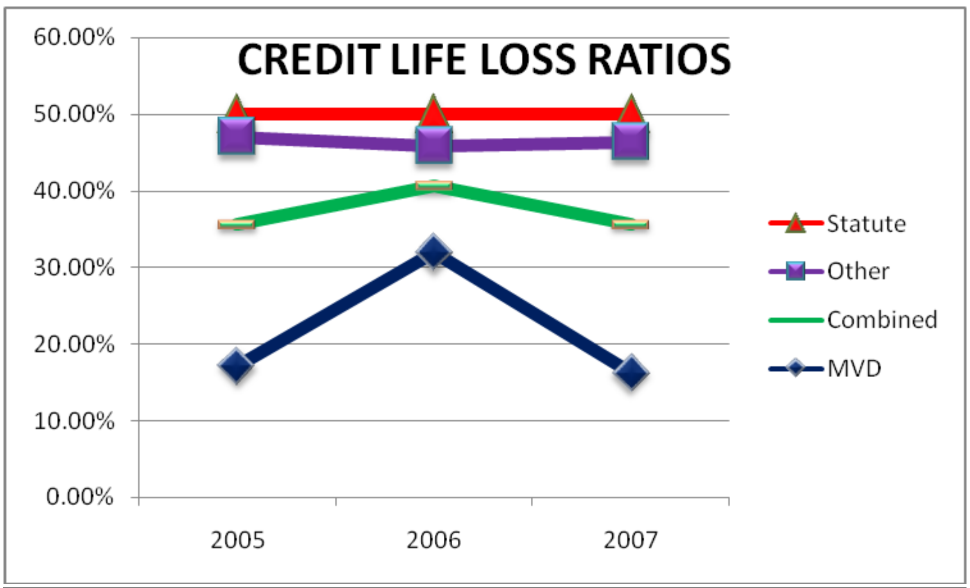
	2005	*2006*	*2007*	*Total 2005-2007*
Direct Premium Earned	12,280,521	12,241,671	11,172,823	35,695,015
Direct Losses Incurred	4,380,906	4,965,698	3,992,800	13,339,404
Loss Ratio	35.67%	40.56%	35.74%	37.37%

Analysis of Data

Credit life insurance earned premiums decreased by over $1.0 million or 8.5% from 2006 to 2007, mostly within the motor vehicle class of business where premiums decreased from $4.66 million to $3.95 million. Incurred claims decreased even more significantly by almost $1.0 million or almost 20% from 2006 to 2007 after rising by over $500,000 between 2005 and 2006. As the blocks of coverage and remaining policies get smaller, it is not unusual for claims to fluctuate from one year to another.

Comparison to Statutory Standards

As presented in the following graph, the reported loss ratios for credit life insurance in aggregate are below the statutory required loss ratio standards. Credit life insurance products are required to be written at the 50% loss ratio. The aggregate loss ratio for the motor vehicle line of business dropped, however, to 16.33% for the motor vehicle line of business and 46.35% for all non-motor vehicle lines of business in 2007. Although the non-MVD line of business may be close to the statutory standard, it is still below the required level.



Evaluation of the Loss Ratio Results

As noted previously, the Division of Insurance develops the deviated rates for the motor vehicle line of business every three years based on a previous three-year period's experience. The Division most recently issued Bulletin 2007-09 to set the credit life rates for the period between 2008 and 2010 based on reported information from the period between 2004 and 2006. The premium and claims reported for 2007 will be factored into the rates that are set in 2010 to be effective between 2011 and 2013.

For the non-motor vehicle line of business, each of the companies submitted earned premium and claims information which was individually reviewed for the credibility of the reporting information and four companies submitted amended rate filings because their reported loss ratios fell below the statutorily required limits.

Section 4 Credit Accident and Sickness Insurance

The following represents the experience reported by the 29 companies submitting reports for credit accident and sickness insurance business in force between 2005 and 2007:

Motor Vehicle Dealer Class of Business

	2005	*2006*	*2007*	*Total 2005-2007*
Direct Premium Earned	9,013,555	8,515,947	8,400,899	25,930,401
Direct Losses Incurred	2,495,085	2,413,642	1,634,008	6,542,735
Loss Ratio	27.68%	28.34%	19.45%	25.23%

All Other Classes of Business

	2005	*2006*	*2007*	*Total 2005-2007*
Direct Premium Earned	13,745,333	12,980,166	12,043,183	38,768,682
Direct Losses Incurred	5,667,836	5,618,403	4,795,548	16,081,787
Loss Ratio	41.23%	43.28%	39.82%	41.48%

Motor Vehicle Dealer Class and All Other Classes Combined

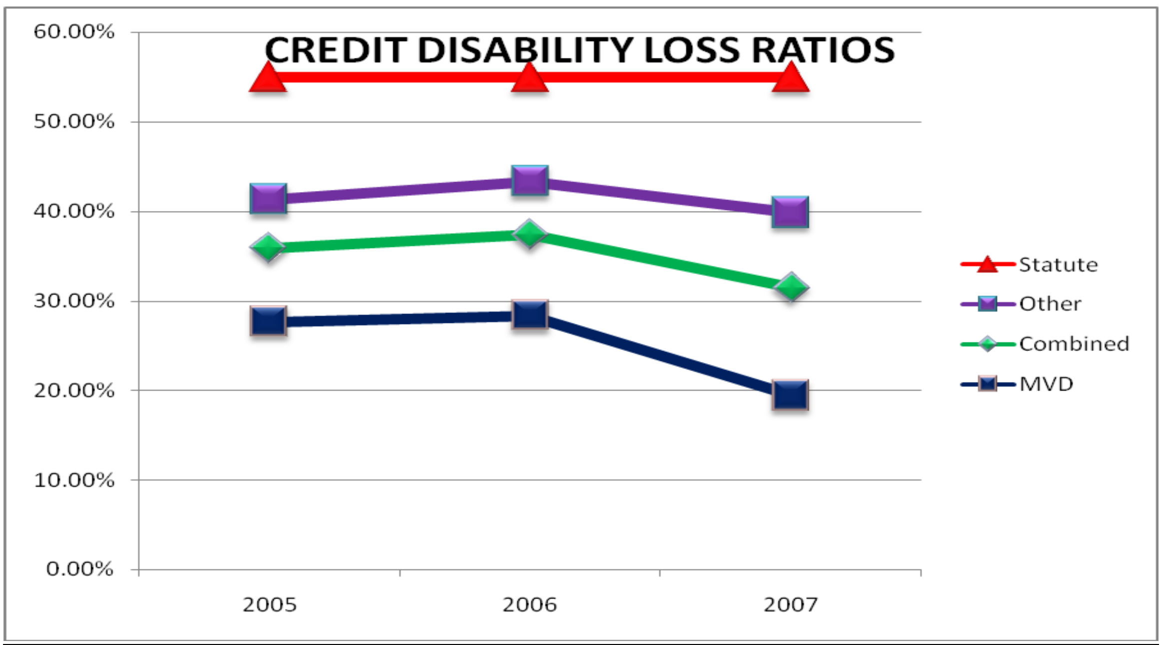
	2005	*2006*	*2007*	*Total 2005-2007*
Direct Premium Earned	22,758,888	21,496,113	20,444,082	64,699,083
Direct Losses Incurred	8,162,921	8,032,045	6,429,556	22,624,522
Loss Ratio	35.87%	37.37%	31.45%	34.97%

Analysis of Data

Credit disability insurance earned premiums decreased by over $1.0 million or almost 5% from 2006 to 2007, mostly outside the motor vehicle class of business where premiums decreased from $12.98 million to $12.04 million. Incurred claims decreased even more significantly by over $1.5 million or by almost 20% from 2006 to 2007 after remaining relatively equal between 2005 and 2006. As the blocks of coverage and the remaining policies get smaller, it is not unusual for claims to fluctuate from one year to another.

Comparison to Statutory Standards

As presented in the following graph, the reported loss ratios for credit disability insurance in aggregate are below the statutory required loss ratio standards. Credit disability insurance products are required to be written at the 55% loss ratio, the aggregate loss ratio for the motor vehicle line of business was 19.45% and 39.82% for all non-motor vehicle lines of business in 2007. Although the non-MVD class of business may be closer to the statutory standard, it is still below the required level.



Evaluation of the Loss Ratio Results

As noted previously, the Division of Insurance develops the deviated rates for the motor vehicle line of business every three years based on a previous three-year period's experience. The Division most recently issued Bulletin 2007-09 to set the credit disability insurance rates for the period between 2008 and 2010 based on reported information from the period between 2004 and 2006. The premium and claims reported for 2007 will be factored into the rates that are set in 2010 to be effective between 2011 and 2013.

For the non-motor vehicle line of business, each of the companies submitted earned premium and claims information which was individually reviewed for the credibility of the reporting information. Six companies submitted amended filings to reduce their credit disability rates, because their reported loss ratios fell below the statutorily required loss ratios.

Section 5 Credit Involuntary Unemployment Insurance

The following represents the experience reported by the eight companies submitting reports for credit involuntary unemployment insurance business in force between 2005 and 2007 (please note that companies do not rate or report separately for the motor vehicle class of business as opposed to the non-motor vehicle class of insurance):

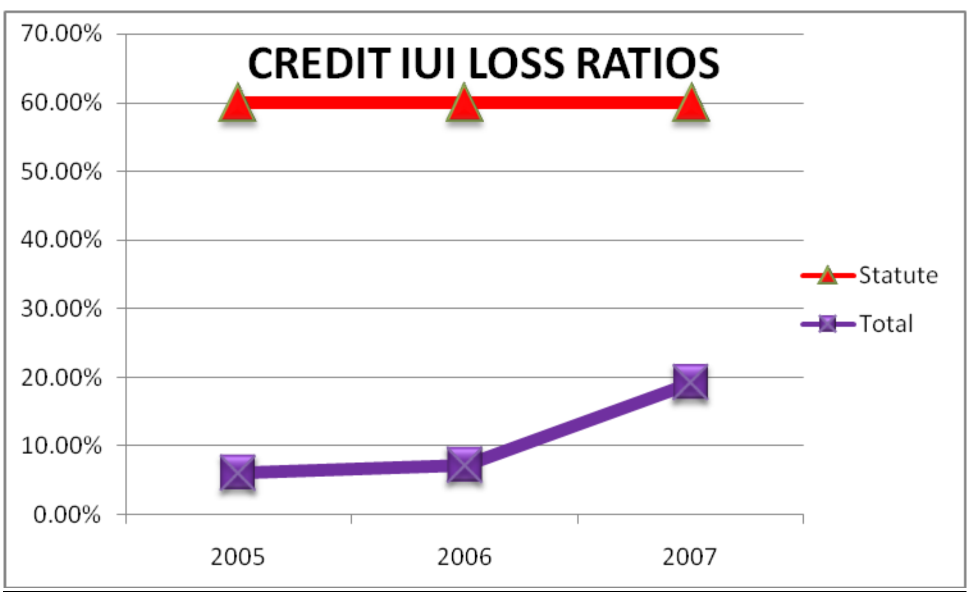
	2005	***2006***	***2007***	***Total 2005-2007***
Direct Premiums Incurred	5,154,640	4,305,534	3,308,849	12,769,023
Direct Losses Earned	315,386	315,002	636,714	1,267,102
Loss Ratio	6.12%	7.32%	19.24%	9.92%

Analysis of Data

Credit involuntary unemployment insurance earned premiums declined by almost $1.0 million or by 23% from 2006 to 2007 which is larger than the $850,000 premium decrease from 2005 to 2006. Incurred claim losses increased, almost doubling from 2006 to 2007, but the loss ratio for credit involuntary unemployment insurance remains under 20%.

Comparison to Statutory Standards

As presented in the following graph, the reported loss ratios for credit involuntary unemployment insurance in aggregate are below the statutory required loss ratio standards. Credit involuntary unemployment insurance products are expected to be written at the 60% loss ratio, however, the aggregate loss ratio is below the required level.



Evaluation of the Loss Ratio Results

Each of the companies submitting earned premium and claims information were individually reviewed for the credibility of the reporting information. Two companies submitted amended filings to reduce their credit unemployment insurance rates as their reported loss ratios were credible and fell below the statutorily required loss ratio.